

H
No. 899

FEB 28 1946

Supreme Court of the United States

(October Term, A.D. 1946)

The Federal National Bank, of Shawnee, Oklahoma,
a corporation,
Petitioner,

V E R S U S

The Continental Savings Company,
a corporation,
Respondent.

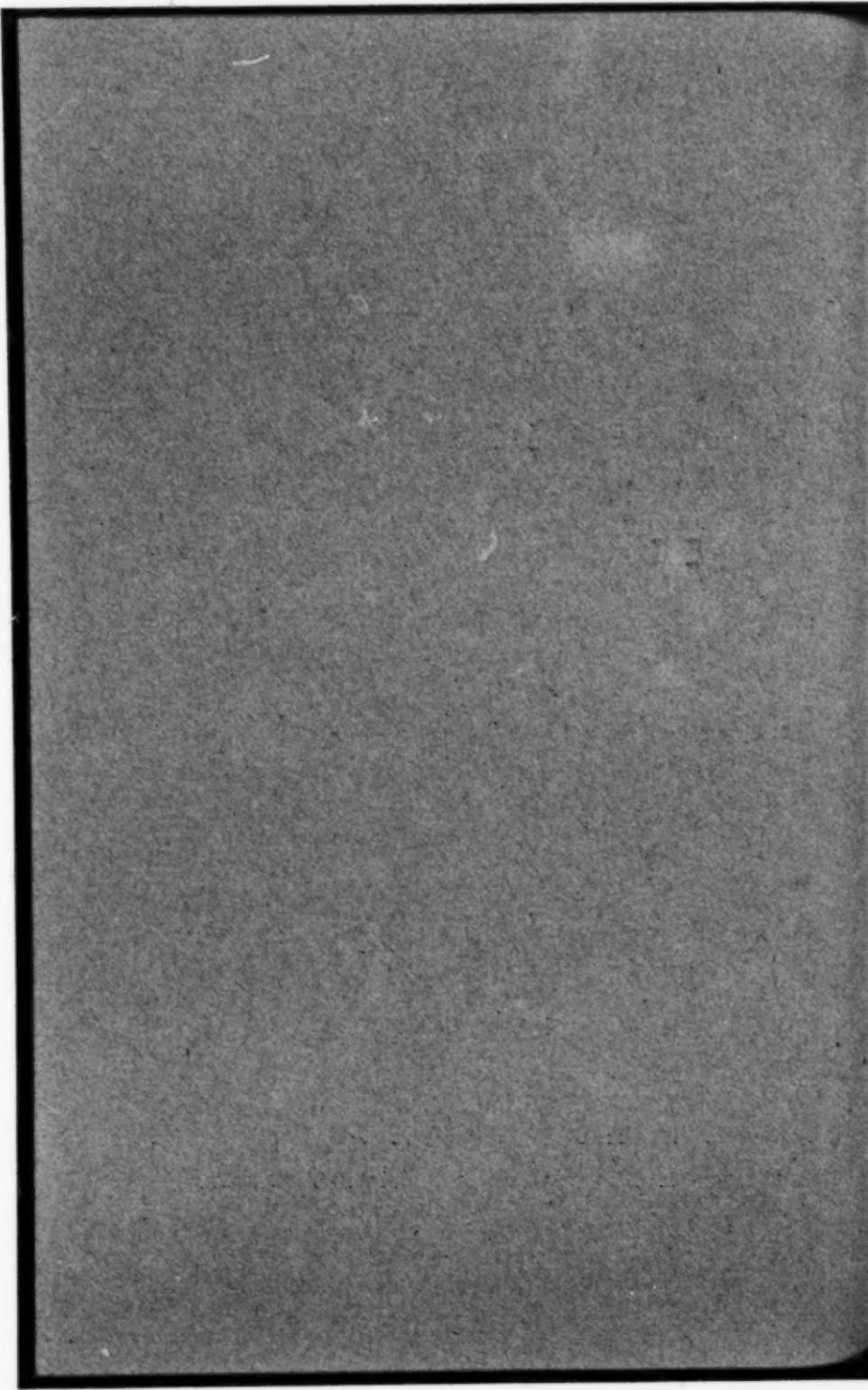
UNITED STATES
SUPREME COURT
IN THE

W. W. Clegg,
American National Bank,
Shawnee, Oklahoma,
Counsel for Petitioner.

JOHN L. GOOS,
American National Bank Building,
Shawnee, Oklahoma,
of Counsel.

February, 1946

WILSON & CO., STAMFORD, CONNECTICUT



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No.

Supreme Court of the United States
(OCTOBER TERM, A. D. 1945)

THE FEDERAL NATIONAL BANK, of Shawnee, Oklahoma,
a corporation,
Petitioner,
VERSUS
THE CONTINENTAL SUPPLY COMPANY,
a corporation,
Respondent.

**PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF AP-
PEALS FOR THE TENTH CIRCUIT AND BRIEF
IN SUPPORT THEREOF**

PETITION FOR WRIT OF CERTIORARI

To the Honorable, the Justices of the Supreme Court of
the United States:

Comes now The Federal National Bank, of Shawnee,
Oklahoma, a corporation, and respectfully petitions this
Honorable Court to grant a writ of certiorari to review
the opinion and decree of the United States Circuit Court
of Appeals for the Tenth Circuit, rendered and entered
on the 29th day of November, 1945, in the case lately pend-
ing in said United States Circuit Court of Appeals for the
Tenth Circuit, styled The Continental Supply Company,

a corporation, Appellant, v. H. G. Marshall, and The Federal National Bank, Shawnee, Oklahoma, Appellees, being No. 3057 of causes on the docket of said United States Circuit Court of Appeals for the Tenth Circuit, reversing the decree of the United States District Court for the Western District of Oklahoma in said cause in favor of the petitioner and against respondent herein; which said decree of the United States Circuit Court of Appeals for the Tenth Circuit became final on the 23rd day of January, 1946, by the denying by that Court of petitioner's petition for a rehearing.

OPINIONS IN THE COURTS BELOW

The opinion of the United States Circuit Court of Appeals for the Tenth Circuit in said cause of The Continental Supply Company, a corporation (plaintiff-appellant) v. H. G. Marshall and The Federal National Bank, Shawnee, Oklahoma (defendant-appellee), which petitioner here seeks to have reviewed, is not yet officially reported, but appears on pages 210 to 225 of the transcript of the printed record filed herewith.

The opinion of the district court is reported in 52 Fed. Supp. at page 717, and is found on pages 40 to 50 of the transcript of record filed herein.

**SUMMARY STATEMENT OF THE MATTER
INVOLVED**

The material controlling facts are:

On July 23, 1941, H. G. Marshall, an oil operator, mortgaged to the petitioner, The Federal National Bank, of Shawnee, Oklahoma, his undivided $\frac{1}{4}$ th interest in certain oil and gas leases known as the Pensoneau and Whitehead leases, located in Pottawatomie County, Oklahoma, together with the personal property located thereon and the oil and gas produced therefrom; the two mortgages, with the exception of the descriptions of the oil and gas leases, were identical in terms, each securing a note of \$20,000.00 and providing for the securing of future advances or indebtedness not to exceed the sum of \$20,000.00 (R. 187-193; 205-207). Both mortgages were recorded as chattel mortgages and as real estate mortgages on the date of their execution (R. 211). Contemporaneously and in accordance with the terms of the mortgages, Marshall executed division orders to the purchaser of the oil and gas from the leases, directing it to pay the proceeds of the oil and gas produced from his interest in the leasehold estates to the "Federal National Bank for H. G. Marshall," and from and after July 30, 1941, until November 30, 1942, the proceeds from the oil produced and sold were paid to the Bank in accordance with the division orders, and by it deposited to the checking account of Marshall, who paid the proportionate share of the operating costs to the operating partner on each of the leasehold estates.

On April 18, 1942, there was recorded in Pottawatomie

County, Oklahoma, a mortgage executed by H. G. Marshall to the Continental Supply Company, respondent, to secure the sum of \$47,137.31, upon one-half of his interest in the Pensoneau and Whitehead lease (R. 18-21). This mortgage expressly recited that it was subject to the prior mortgages of The Federal National Bank. On October 10, 1942, the Supply Company commenced an action in the United States District Court for the Western District of Oklahoma against Marshall and The Federal National Bank, claiming that the mortgage of the Bank had been paid and that the Bank had received money from the oil and gas runs in excess of its mortgaged indebtedness and asking for a judgment against the Bank for an accounting and for the amount of the excess oil and gas runs, asserted to be \$25,075.86, and for a receiver, foreclosure of its mortgage and other relief. The United States District Court, after trial, rendered judgment in favor of the Supply Company against Marshall and ordered a foreclosure of the mortgage security. The court found that the Supply Company should not recover against the Bank and rendered judgment in favor of the Bank giving it a first and prior lien upon the Pensoneau and Whitehead lease interest to secure the payment of an unpaid balance upon its mortgages of \$1,547.76. (Judgment, 59-62). Jurisdiction of the U. S. Court was based exclusively on diversity of citizenship.

The Supply Company appealed contending that all advances made by the Bank to Marshall after actual notice to the Bank of the existence of the mortgage to Continental

should be subordinated to the lien of the mortgage of the Supply Company under the rule laid down in the Washington case of *Elmendorf-Anthony Co. v. Dunn et al.*, 116 Pac. (2d) 253, 138 A. L. R. 558, and further contending that by reason of certain errors committed by the trial court in the accounting (which are not material here) that a proper accounting would show the Bank indebted to the Supply Company for the amount claimed in its petition.

Both in the trial court and in the Circuit Court of Appeals the Bank contended that its mortgages, insofar as the oil and gas runs were concerned, were chattel mortgages under Oklahoma law and that by virtue of the Oklahoma statute, same being Section 75, Title 46, Oklahoma Statutes Annotated 1941, reading:

“Any chattel mortgage may secure future advances to be made by the mortgagee or assignee, at this or its option for any purpose, but not to exceed in the aggregate an amount stated in said mortgage; and all advances so made shall be secured by such mortgage equally, to the same extent and with the same priority, as the amount originally advanced on the security of such mortgage and such advances may be made and repaid and again made and the amount so stated shall be considered only as the total amount of such advances as may be outstanding at one time,”

the law of other jurisdictions pertaining to future advances would not apply and the Supply Company was therefore not entitled to an accounting concerning loans made by the Bank to Marshall after the execution of the mortgage

to Continental, inasmuch as the statute gave such advances, the same priority as was held by the original indebtedness secured by such mortgages. The Circuit Court of Appeals declined to follow the Oklahoma statute, saying that the mortgages of the Bank should be considered as real estate mortgages in their entirety and after finding that the trial court had made certain errors in its accounting vacated the judgment in favor of the Bank and reversed the cause, with directions to the trial court to proceed with an accounting against the Bank in accordance with the views expressed in the opinion. Inasmuch as Marshall has no interest in this proceeding and is not affected thereby only the Bank is asking certiorari.

In its opinion the Circuit Court of Appeals recognized that under Oklahoma law a valid chattel mortgage upon oil and gas to be produced could be given; that the mortgages from Marshall to the Bank contained such valid chattel mortgages; but held that the mortgages of the Bank as a whole were required under Oklahoma law to be recorded as instruments relating to real estate and were therefore real estate mortgages.

The decision of the United States Circuit Court of Appeals for the Tenth Circuit was rendered on the 29th day of November, 1945, and within the time required under the rules of said Court petitioner filed petition for rehearing, calling attention to the Oklahoma law applicable and urging that the Circuit Court of Appeals had failed to follow the Oklahoma law (R. 227-249). On January 23, 1946, petition for rehearing was denied (R. 258).

The duly certified record, including all the proceedings in said cause in said United States District Court for the Western District of Oklahoma and the United States Circuit Court of Appeals for the Tenth Circuit is filed herewith under separate cover. If the Circuit Court of Appeals was right in the refusal to follow the Oklahoma statute, then a reversal of the case was proper. If it was wrong, then the judgment of the U. S. District Court should have been affirmed; all errors in the accounting being immaterial, and harmless, unless the lien of the Continental Mortgage is given priority over the advances made by the Bank to Marshall after the execution of the Continental Mortgage.

JURISDICTION OF THIS COURT

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended by Act of February 13, 1925, and that portion of Subsection (b) of Paragraph five (5) of Rule thirty-eight (38) of Revised Rules of the Supreme Court of the United States, made in pursuance thereof, *viz*:

“Where a circuit court of appeals has decided an important question of local law in a way probably in conflict with applicable local decisions.”

This cause originated in the United States District Court for the Western District of Oklahoma and was reviewed on appeal by the United States Circuit Court of Appeals for the Tenth Circuit.

The opinion of the Circuit Court of Appeals was filed on November 29, 1945, but petition for rehearing was filed in time allowed under rules of said Court and denied, and final decree was entered on January 23, 1946.

Cases thought to sustain the jurisdiction are:

—*Rorick v. Devon Syndicate*, 307 U. S. 299, 83 L. Ed. 1303;

Fidelity Union Trust Company v. Field, 311 U. S. 169, 85 L. Ed. 109;

West v. American Tel. & Tel. Company, 311 U. S. 223, 85 L. Ed. 139;

Meredith v. Winterhaven, 320 U. S. 228, 88 L. Ed. 9;

Cities Service Oil Company v. Dunlap, 308 U. S. 208, 84 L. Ed. 196;

Guaranty Trust Company v. York (not yet officially reported) L. Ed., Advance Opinions, Vol. 89, page 1418.

QUESTIONS PRESENTED

The questions presented by petitioner's petition herein for a writ of certiorari are:

(1) Has the Circuit Court of Appeals erroneously held contrary to the applicable Oklahoma law that a mortgage upon an interest in an oil and gas lease is not a chattel mortgage?

(2) Has the Circuit Court of Appeals erroneously held contrary to Oklahoma law that a mortgage upon per-

sonal property contained in an instrument relating to real estate is not a chattel mortgage?

(3) Has the Circuit Court of Appeals erroneously failed to apply as the rule of decision in this case the comprehensive terms of a plain unambiguous statute of Oklahoma, to-wit:

Sec. 75, Title 46, Oklahoma Statutes Annotated 1941?

**REASONS RELIED ON FOR THE ALLOWANCE
OF THE WRIT**

(1) The final decision of this case will have important results. The oil and gas fields in the mid-continent are usually discovered or opened up by independent operators whose resources are not unlimited. Mortgages upon producing oil and gas leases are commonly used to finance their operations. Additional advances under these mortgages are frequently required from time to time by many of these operators, although such advances are not used upon the particular mortgage security, but are used for other purposes; such as meeting payrolls; starting new drilling operations, etc. Unless the mortgagees of such independent oil operators can be protected in making such advances from the intervening liens of subsequent creditors, the whole method of present financing in Oklahoma will have to be revised. Under the decision of the Circuit Court of Appeals, optional advances by the mortgagee of oil and gas leaseholds or interests in oil and gas

leaseholds are virtually eliminated for all practical purposes because of the hazards of intervening claims.

(2) The Circuit Court of Appeals has declined to apply the plain terms of an unambiguous statute of Oklahoma to the case at bar and has in effect by judicial construction created an exception to the all inclusive terms of the statute, under circumstances which call for no construction. The statute, Sec. 75, Title 46, Oklahoma Statutes Annotated 1941, by its terms applies to the holder of "any chattel mortgage," meaning the holders of every kind of chattel mortgage known to Oklahoma law. Yet the Circuit Court of Appeals by its decision herein creates an exception to this comprehensive term of the statute by denying the protection of the statute to the holder of a chattel mortgage contained in an instrument affecting or relating to real estate. Only the people or the courts of Oklahoma should create such an exception. It is the proper function of the federal courts to ascertain what the State law is and not what it ought to be. *Klaxon v. Stenton Mfg. Co.*, 313 U. S. 487, 85 L. Ed. 1477. Whenever that law is authoritatively declared by a State, whether its voice be the legislature or its highest court, such law ought to govern in litigation founded on that law, whether the forum of application is a state or a federal court and whether the remedies be sought at law or may be had in equity. *Guaranty Trust Co. v. York*, decided June 18, 1945, not yet officially reported, L. Ed. 89, page 1418.

SPECIFICATIONS OF ERRORS

Petitioner says that the United States Circuit Court of Appeals for the Tenth Circuit has erred:

- (1) In erroneously holding that a mortgage upon an interest in an oil and gas lease is not a chattel mortgage, contrary to applicable Oklahoma law.
- (2) In erroneously holding contrary to Oklahoma law, that a mortgage upon personal property contained in an instrument relating to real estate is not a chattel mortgage.
- (3) In failing to apply as the rule of decision herein, the comprehensive terms of a plain unambiguous statute of Oklahoma, same being Sec. 75, Title 46, O. S. A. 1941.

PRAYER

Wherefore, petitioner prays that a writ of certiorari be issued by this Court directed to the United States Circuit Court of Appeals for the Tenth Circuit to the end that the same opinion and decree of said United States Circuit Court of Appeals for the Tenth Circuit in said cause of The Continental Supply Company, a corporation, Appellant, vs. H. G. Marshall and The Federal National Bank, Shawnee, Oklahoma, Appellees, No. 3057 be reviewed by this Court as provided by law, and that upon

—12—

such review said decree be reversed, and that petitioners have such other relief as to this Court may seem appropriate.

MARK GOODE,
Counsel for Petitioner.

JOHN L. GOODE,
Of Counsel.





**BRIEF IN SUPPORT OF PETITION FOR
WRIT OF CERTIORARI**

OPINION OF THE COURT BELOW

The opinion of the United States Circuit Court of Appeals for the Tenth Circuit in said cause of The Continental Supply Company, a corporation, (plaintiff-appellant) v. The Federal National Bank, Shawnee, Oklahoma (defendant-appellee), which petitioner here seeks to have reviewed, is not yet officially reported but appears on pages 210 to 225 of the transcript of the printed record filed herewith.

STATEMENT OF THE CASE

The essential facts of the case are fully stated in petitioner's petition for a writ of certiorari, and in the interest of brevity are not repeated here. Reference will be made to such facts, on points involved, in the course of the argument which follows:

SPECIFICATIONS OF ERRORS TO BE URGED

Petitioner says that the United States Circuit Court of Appeals for the Tenth Circuit has erred:

- (1) In erroneously holding that a mortgage upon an interest in an oil and gas lease is not a chattel mortgage, contrary to applicable Oklahoma law.

(2) In erroneously holding contrary to Oklahoma law, that a mortgage upon personal property contained in an instrument relating to real estate is not a chattel mortgage.

(3) In failing to apply as the rule of decision herein, the comprehensive terms of a plain unambiguous statute of Oklahoma, same being Section 75, Title 46, Oklahoma Statutes Annotated 1941.

SUMMARY OF THE ARGUMENT

1.

Neither an oil and gas lease nor any interest therein is either real estate or real property in Oklahoma; they are personal property. Consequently, a mortgage upon an interest in an oil and gas lease can not be a real estate mortgage. A mortgage upon a lease or leasehold has been specifically held by the Oklahoma Supreme Court to be a chattel mortgage and not a real estate mortgage.

Widick v. Phillips Petroleum Co., 173 Okla. 325, 49 Pac. (2d) 135. As pointed out in this case the requirements of the recording act do not change the character of the leasehold. It remains personal property, notwithstanding the recording act. The decision in this case is contrary to the principles of *Widick v. Phillips Petroleum Co.*, *supra*.

II.

The mere fact that a chattel mortgage is contained in an instrument which is required, under Oklahoma law,

to be recorded as an instrument "relating to real estate" does not convert a chattel mortgage into a real estate mortgage and the instrument must also be recorded as a chattel mortgage to meet the requirements of Oklahoma law. The decision of the Circuit Court of Appeals in this case to the contrary is in conflict with the decision of the Supreme Court of Oklahoma, the Court of last resort in Oklahoma, in the case of *Abraham v. American National Bank*, 161 Okla. 87, 17 Pac. (2d) 480.

III.

The Oklahoma statute in question (Sec. 75, Title 46, Oklahoma Statutes Annotated 1941) applies to all chattel mortgages. Under Oklahoma law a chattel mortgage is a mortgage of personal property and such chattel mortgage may be included in a lease or other instrument affecting real estate or created by a separate instrument. The statute applies to all such chattel mortgages.

It is obvious that the purpose of the statute is to secure the priority of optional advances made upon the security of personal property and the classification of the statute rests upon the depreciable character and fluctuating value, the changing conditions and other elements inherent in the very nature of personal property. If any exception is created to the plain unambiguous terms of the statute it should be done by the Legislature or people of Oklahoma and not by judicial decree of a Federal Court.

A R G U M E N T

I.

The Circuit Court of Appeals should have held that the Bank's mortgages were chattel mortgages. Clearly the mortgages were chattel mortgages in so far as they covered the oil and gas to be produced and the lease equipment. The mere fact that they also covered Marshall's interest in the Pensoneau and Whitehead leases does not prevent them from retaining their essential character of chattel mortgages under Oklahoma law. Oil and gas are personal property in Oklahoma.

Keystone Pipe and Supply Co. v. Crabtree, 174 Okla. 564, 50 Pac. (2d) 1086.

In *American National Bank of Wetumka v. Hightower*, 184 Okla. 294, 87 Pac. (2d) 311, the Oklahoma Supreme Court approved this definition of a chattel mortgage as:

“* * * a contract made by the owner by which specific personal property is hypothecated for the performance of an act without the necessity of a change of possession.”

Section 51, Title 46, Oklahoma Statutes Annotated 1941, provides as follows:

“Form of chattel mortgage

“A mortgage of personal property may be made in substantially the following form:

“This mortgage, made the _____ day of _____ in the year _____ by A. B. of _____, by occupation a _____, mortgagor, to C. D. of _____ by occupation a _____

mortgagee, witnesseth. That the mortgagor mortgages to the Mortgagee (here described the property), as security for the payment to him of _____ dollars, on (or before) the ____ day of _____ in year____ with interest thereon (or security for the payment of a note or obligation describing it, etc.)."

An oil and gas leasehold interest in Oklahoma is personal property:

"A leasehold interest in the oil, gas and minerals in Oklahoma is personal property."

—*Duff v. Keaton*, 33 Okla. 92, 124 Pac. 291.

In *State v. Shamblin*, 185 Okla. 127, 90 Pac. (2d) 1053, the Court said:

"It has been consistently held by this court that an oil and gas mining lease is not real property nor a freehold or corporeal interest therein, and that the execution of such a lease does not constitute a conveyance of lands, tenements, or other realty, or of a freehold or corporeal interest therein. * * * It has also been repeatedly and consistently held that such oil and gas mining leases are chattels real and are therefore personal property."

An oil and gas lease is not real estate.

—*First National Bank of Healdton v. Dunlap*, 122 Okla. 288, 254 Pac. 729;

Pauline Oil & Gas Co. v. Fischer, 191 Okla. 346, 130 Pac. (2d) 305.

An oil and gas lease is not real property.

—*Clark v. Mercer Oil Co.*, 139 Okla. 48, 281 Pac. 283.

Consequently a mortgage upon an oil and gas lease can not be a real estate mortgage because the security is not real property or real estate but personal property. Furthermore in Oklahoma it has been held that a mortgage upon a lease or leasehold is a chattel mortgage or mortgage upon personal property and not a mortgage upon real estate. See exhaustive opinion in *Widick v. Phillips Petroleum Co.*, 173 Okla. 325, 49 Pac. (2d) 132. The requirements of the recording act do not change the essential character of the chattel mortgage. It remains a mortgage upon personal property and does not become a real estate mortgage. *Widick v. Phillips Petroleum Co.*, *supra*.

II.

The Circuit Court of Appeals found that a chattel mortgage may be included in a mixed mortgage or real estate mortgage; that a valid chattel mortgage may be given upon oil and gas to be produced; that insofar as the mortgages of the Bank are concerned, the parties intended to and did mortgage the oil and gas and that to this extent the mortgages of the Bank are chattel mortgages, but also held that because the liens of the Bank upon the oil and gas were contained in instruments required to be recorded as instruments relating to real estate, the liens in some way lost their characteristics as chattel mortgages and became real estate mortgages *in toto* and must be considered as such. This reasoning is contrary to the express

holding of the Supreme Court of Oklahoma in the case of *Abraham v. American National Bank*, 161 Okla. 87, 17 Pac. (2d) 480. In that case a chattel mortgage was contained in a written lease contract. The lease contract was an instrument affecting real estate and was recorded as such and it was urged that the record of the lease as an instrument relating to real estate was sufficient to impart notice as to the lien therein contained upon the personal property, and that it was unnecessary to record the instrument as a chattel mortgage. The Court held that it was necessary to record the instrument both as an instrument affecting real estate and as a mortgage of personal property, saying:

"In the instant case, the instrument was one affecting both real and personal property. It consisted in the main of an instrument conveying an interest in real estate, and it was therefore the duty of the clerk to record it as such. * * * Plaintiff had ample time after return of his lease contract, and prior to the execution of defendant's mortgage—to have filed the same as a chattel mortgage. He failed to do so. * * * The recording of the instrument here involved as one affecting real estate was insufficient to impart notice to third parties that plaintiff had a lien against the property."

It will thus be seen that the mere fact that an instrument containing a lien upon personal property is also an instrument affecting real estate and has been recorded as such does not change the character of the entire instrument into a real estate mortgage or dispense with the necessity of recording the lien on personal property as a

chattel mortgage. Furthermore a lien upon an oil and gas lease does not cover oil and gas when produced therefrom. *Stanolind Crude Oil Purchasing Co. v. Busey*, 185 Okla. 200, 90 Pac. (2d) 876. So that in this case the liens specifically provided for in the mortgages of the Bank upon the oil and gas when produced and upon the proceeds thereof, should be treated as chattel mortgages and the statute authorizing future advances by the holder of "any chattel mortgage" is applicable and controlling.

III.

The Oklahoma statute is plain and unambiguous. There is no room for statutory construction. The statute applies to "any chattel mortgage." The meaning of the statute is clear. The statute reads:

"Any chattel mortgage may secure future advances to be made by the mortgagee or assignee, at this or its option for any purpose, but not to exceed in the aggregate an amount stated in said mortgage; and all advances so made shall be secured by such mortgage equally, to the same extent and with the same priority, as the amount originally advanced on the security of such mortgage and such advances may be made and repaid and again made and the amount so stated shall be considered only as the total amount of such advances as may be outstanding at one time."

—Section 75, Title 46, Oklahoma Statutes Annotated 1941.

It is evident that the intent of the statute is to base the right to make future advances upon the character of

security covered by the mortgage. It was clearly the intent to create such right for the benefit of persons making loans upon personal property. The Legislature evidently intended to give the persons who loaned on personal property the right to make such advances as the mortgagee should deem necessary for the best interest of himself and the mortgagor during the continuance of their relationship without being confronted or embarrassed with the claims of junior lien holders; seeking to apply the principle of the Elmdorf-Anthony Case. The depreciable character, the fluctuating value, the changed conditions and other elements inherent in the very nature of personal property all are readily seen as concurring factors entering into the legislative policy of Oklahoma expressed in this statute. The statute was designed to extend relief to all mortgagees of personal property without regard to whether their liens were contained in mixed mortgages, lease contracts or instruments affecting real estate or in simple, uncomplicated chattel mortgages. Nowhere is there any evidence of an intent to deny the benefit of this statute to a mortgagee whose chattel mortgage is contained in a mixed mortgage or instrument affecting real estate or to grant it only to the holders of simple chattel mortgages recorded as such and unencumbered by any other covenants or contractual obligations.

It is respectfully submitted that the questions involved in this case have not been decided according to the law of Oklahoma although Federal jurisdiction herein rests exclusively upon diversity of citizenship and that this

Honorable Court should grant certiorari herein and affirm the judgment of the United States District Court for the Western District of Oklahoma.

Respectfully submitted,

MARK GOODE,
American National Bank Building,
Shawnee, Oklahoma,
Counsel for Petitioner.

JOHN L. GOODE,

American National Bank Building,
Shawnee, Oklahoma,

of Counsel.

February, 1946.

